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E.O. 12958: DECL: 10/09/2019
TAGS: ECON EFIN VE
SUBJECT: VENEZUELA: CONCRETE ECONOMIC MEASURES STILL
LACKING; QUESTIONS SURROUNDING BOND ISSUANCE

REF: A. CARACAS 1283
¶B. CARACAS 368
¶C. 2008 CARACAS 838
¶D. CARACAS 750
¶E. CARACAS 494

Classified By: Economic Counselor Darnall Steuart for reasons 1.4 (b)
and (d).

¶1. (C) Summary: Despite weeks of anticipation, a press conference by the Venezuelan government's (GBRV's) three top economic officials yielded little in the way of concrete new economic measures. The officials outlined general economic goals but offered no significant new proposals that would change the course of Venezuela's economy, which the Central Bank president tacitly acknowledged is heading into a recession. The GBRV is in a policy trap of its own making: economic measures that could have a major impact on the economy would require the GBRV to reduce its control, something that runs contrary to Chavez's nature. Questions surround a recent bond issuance touted as an unqualified success by the Minister of Finance, perhaps the most puzzling of which is why the GBRV priced the bonds so low, thus allowing purchasers to make a substantial and immediate profit. The answer may lie in the GBRV's desire to reduce the parallel foreign exchange rate. End summary.

Waiting for Godot?

¶2. (SBU) An October 8 press conference by the GBRV's three key economic officials, billed as the venue for the long-awaited announcement of new economic measures, was sorely lacking in concrete proposals. Minister of Planning and Development Jorge Giordani, Minister of Economy and Finance Ali Rodriguez, and Central Bank president Nelson Merentes lauded the GBRV's economic and social achievements under President Chavez, criticized the U.S. economic model, and offered general statements about the GBRV's economic goals and strategies to meet them. They did not offer concrete measures beyond what GBRV leaders had already announced. Although they claimed other ministers would announce measures in coming days, the lack of specificity was anticlimactic after almost two months of speculation about what these measures would be. This speculation was fueled by repeated reference by President Chavez to unspecified economic measures under consideration; at one point he claimed to be reviewing 54 such proposals.

¶3. (U) Giordani outlined three general goals for GBRV economic policy: growth, employment, and control of inflation. Rodriguez stated the GBRV would focus on increasing agricultural production and productivity and building more housing, saying efforts in these areas would jump-start the economy and help contain inflation. He noted investments in infrastructure and a reorientation of the financial sector would be required to achieve agricultural and housing goals, arguing in particular that banks must become more productive intermediaries in the economy rather than investing in securities. Among the most concrete of the points offered by the officials, Rodriguez stated more bond issuances would be coming (starting, most likely, with PDVSA), and Merentes offered 60 percent as the GBRV's target difference between the official and parallel foreign exchange rates. (Note: The official rate is currently 2.15 bolivars (Bs)/USD, making Merentes' target parallel rate 3.44 Bs/USD. The current parallel rate is 5.3 Bs/USD. End note.) In a tacit acknowledgement that the Venezuelan economy is in recession, Merentes commented that GDP growth for the year would be "around zero" and might well be negative.

Questions Surround Recent Bond Issuance

¶4. (SBU) In the press conference, Rodriguez characterized the GBRV's recent bond issuance (see ref A for terms) as an unqualified success. The GBRV sold dollar-denominated bonds with a face value of USD 5 billion into the local market. Buyers purchased the bonds in bolivars (Bs) at 140 percent of face value at the official rate of 2.15 Bs/USD; thus, the GBRV raised approximately Bs 15 billion. At the 140 percent

price, one analyst calculated that the implicit exchange rate associated with the issuance was 4.3 Bs/USD. (Note: The implicit exchange rate is calculated by dividing Bs spent in purchasing a given quantity of bonds by USD received upon immediate sale of the bonds in international markets. End note.) Observers have raised questions surrounding the issuance, including why the GBRV chose an adjudication methodology that seemed to reward banks and brokerages at the expense of corporations and whether brokerages actually received deposits from bidders as required in the terms. Another question is why the GBRV fixed the price to leave such a large gap between the implicit and parallel exchange rates. This gap allowed purchasers to essentially make an immediate 19 percent profit (albeit, after having assumed some risk on the price of the bond in international markets).

Comment

¶5. (C) After almost two months of speculation, it has become clear that the new measures, whatever they turn out to be, are unlikely to represent a significant departure from present GBRV economic policy. This should come as no surprise: over the past 16 months, President Chavez has twice made major economic policy speeches to much fanfare but with little content aside from small changes to tax policy and the announcement of debt issuances (refs B and C). The GBRV is in a policy trap of its own making: economic measures that could have a major impact on the economy would require the GBRV to reduce its control (or, in the case of devaluation, lose political face), something that runs contrary to Chavez's nature (ref D).

¶6. (C) Rodriguez's stated desire for banks to become more productive intermediaries is a good example of this trap. Banks are reducing their real lending because the private sector does not want to invest, and they are increasing their holdings of securities because the Central Bank and GBRV have provided them incentives to buy the large quantities of local debt the GBRV is issuing (ref E). In other words, GBRV

policies are the underlying reason banks are reducing their intermediation. "Moral persuasion," the method advocated by Giordani to cause banks to increase intermediation, is unlikely to work effectively. Absent a significant increase in oil prices, the GBRV will have to make drastic changes to its economic model to achieve this goal.

¶7. (C) It is hard to know whether there was fraud surrounding the bond issuance, as some observers have alleged. We think it plausible that the GBRV, and specifically Merentes, set the price not to maximize bolivar proceeds for the GBRV but rather to send a strong signal to parallel market players about the GBRV's intentions to lower the parallel rate. Given this strategy, purchasers would have the chance to make an immediate profit. Of course, the people benefitting from this strategy are not Venezuela's poor, but rather its rich (Chavista and non-Chavista alike). The bond issuance, in other words, is another example of the contradictions inherent in Bolivarian economic policy. End comment.
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